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Borrowing To Increase Farm Earnings With Minimum Risk

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UNIVERSITY OF ILLINOIS
COLLEGE OF AGRICULTURE
EXTENSION SERVICE IN AGRICULTURE
AND HOME ECONOMICS

CIRCULAR 770

FARM FAMILIES are often justified in borrowing money to meet current operating expenses and to make capital investments that will increase farm earnings. It is not always wise, however, for a particular farm family to borrow. Before deciding to borrow, you should consider carefully such factors as family energy, farming knowledge, and management ability. And, most important, you should weigh the increase in risk.

Borrowing does increase risk — more for the borrower than for the lender. The lender risks only the amount of his loan, but a borrower stands to lose his accumulated savings should the “breaks of the game” go against him. If you follow the rules given below, however, you should be able to keep your risk at a minimum.

TEN RULES FOR THE SOUND AND WISE USE OF CREDIT

1. Farm-production loans should be used only for purposes that will increase income. Families with limited resources have a hard enough time getting farm credit at best; so it shouldn't be used for nonproductive purposes. Needed machinery, livestock, fertilizers, seed, feed, etc., will earn income; they represent productive investments.

2. Limit borrowing for enterprises which you do not fully understand. First prove yourself in a particular farm enterprise before expanding it materially through the use of borrowed funds. Some enterprises, in order to be most profitable, call for a high degree of technical knowledge and a high level of management efficiency. If you are not sure that you measure up to these requirements in the particular phase of farming you wish to expand, go slow in your borrowing.

3. Keep your debts as low as you can without reducing efficiency. If you have limited resources, it is safer to start small and grow into a bigger business than to try to do too much at once. To keep down your indebtedness, use your loan for purposes that will not only bring you the largest dollar return per dollar borrowed but will also do this in the shortest length of time.

4. Study price trends and be governed by your judgment regarding them. Debts are stated in dollars. But dollars may mean different quantities of goods with different price levels. Suppose, for example, that you are a livestock farmer and that you borrow when top cattle are bringing \$33 a hundredweight. But when you come to repay your loan, cattle are bringing only \$25. Obviously, it will take more cattle to repay your loan than at the time you borrowed.

You could easily make a serious mistake by borrowing too much on the assumption that unusually high prices would prevail long enough to repay a long-term or even a two- or three-year loan.

5. Keep debts in line with your net worth. Your net worth is the difference between what you own and what you owe — assets minus liabilities. Any serious break in the farm price level would tend to reduce your assets without reducing the financial obligations that you have assumed. Under these circumstances a net worth that would be adequate with a high price level might be entirely wiped out.

6. Keep debts in line with your probable income. Work out a farm plan in terms of your production program and probable income and expenses for the coming year, assuming that you can obtain the loan you want.¹ By subtracting your estimated cash farm expenses from your estimated gross income, you will have an idea of the cash that will be available for family living expenses during the year and for payments on the loan.

7. Select a dependable lender who will give the best terms. A farm loan has some of the features of goods and commodities. Lenders sell the “use of money,” and borrowers buy it. The costs of money and the terms of loans will usually vary with different lenders. So it may pay you to “shop around” for your credit needs. The proven willingness and ability of a lender

¹ A one-sheet farm-plan form and an explanatory sheet prepared for this purpose may be obtained from your farm adviser.

to make necessary payment adjustments in distressed times also need to be considered.

8. Have a definite repayment program. Debts incurred for annual operating expenses should be repaid from the proceeds of the crops or livestock for which the money was used. Borrowed funds invested in livestock, equipment, or other farm-production facilities that will serve for several years may need to be repaid over a period of two or more years. But loans for such purposes should be paid off before the items purchased with the borrowed funds become unproductive.

9. Be businesslike, fair, and frank with your lender. When loan payments are due, meet them promptly. If circumstances become such that you cannot do this, discuss your situation with your lender as far in advance of the due date as possible. At that time you should be prepared to say just what you can do, and perhaps also be ready to show how a forced payment, if insisted upon, would reduce your earning position. Most lenders will realize that in effect they are in partnership with you and so will be inclined to make arrangements that will best serve your interests without undue risk to themselves.

10. Have adequate insurance for added risks. Property, liability, and life insurance are a partial protection against the risks created by borrowing. Make sure you have adequate property and liability coverage. Life insurance with minimum savings features offers the cheapest kind of protection for the farm family with a substantial debt. Term insurance with no endowment provisions is a form of life insurance frequently used for this purpose.

Adapted by A. T. ANDERSON, Associate Professor of Agricultural Economics, from writings of the late L. J. Norton, Professor of Agricultural Economics, who during his lifetime was recognized as a leading authority on the use of credit in farming.